Report of the California Department of Insurance

Dangerous Prescription

An Assessment of Health Savings Accounts and Their Impact on the Health Care System

Commissioner John Garamendi

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The use of health savings accounts (HSAs) has been touted by President Bush and some healthcare analysts as a solution to the U.S. health care crisis. Signed into law by President George Bush in 2003, HSAs have been promoted as a method to both expand coverage to the uninsured and to contain health care costs. With an estimated 3 million enrollees, HSAs are poised to become a major new force in America's evolving health system.

However, little research or discussion has taken place regarding the types of changes that HSAs may bring. This report seeks to remedy the dearth of information, as well as stimulate substantive discussion on the subject. It compiles available information on HSAs from a variety of academic sources and from a California Department of Insurance investigatory hearing on HSAs held in September 2005. While the available research is still preliminary, there is clear reason to believe that consumer-driven HSAs are the wrong approach for California's — and America's — health care system. Far from a solution, HSAs are truly a dangerous prescription.

BACKGROUND

Over the past several years, there has been a growing interest in consumer-driven health care (CDHC). Under this theory, patients become informed, more selective consumers who are able to seek out and use the providers who are most effective at providing high quality care at the lowest price. To stimulate this transformation, patients are forced to bear more of the direct financial responsibility for their health care through increased cost sharing.

HSAS & HDHPS EXPLAINED

The most common way to implement CDHC is through the use of high-deductible health plans (HDHPs). The reason is obvious – if a health plan does not provide any coverage for the first $1,000 in health care spending, then the CDHC theory contends that the individual will more carefully consider how best to spend that $1,000.

In 2003, Congress added HSAs as an incentive to promote CDHC.[1] Created as part of the 2003 Medicare Reform Bill, HSAs are tax-free accounts that must be combined with plans having a deductible of at least $1,000 for an individual and $2,000 for a family. This amount is indexed to inflation and grows over time.[2] The maximum contribution to the account — which can be made by the employer, employee, or a combination of the two — is the lower of either the deductible amount, or $2,600 for an individual, or $5,150 for a family. Accounts are owned by employees, are portable across employers, earn tax-free investment income, and can roll over year to year. Funds can be withdrawn for non-medical reasons, though taxes will apply if the individual is under 65. Withdrawals for medical reasons are always tax deductible.

TRENDS IN CDHC

To date, CDHC products have not successfully penetrated the health care marketplace.[3] In fact, employee acceptance is low for HSAs when they are offered as an option with traditional plans. Employees who do select HSAs tend to be healthier and earn higher incomes.[4]

However, HSAs seem poised to begin a rapid increase. A recent publication by an industry trade group asserts that 3 million individuals now have HSAs.[5] This is 20 percent higher than the 2.5 million predicted to have enrolled by the end of 2005.[6] In addition, a 2005 national survey of large employers by Watson Wyatt and the National Business Group on Health found that 8 percent of large employers offered HSAs at the time and that the number would grow to 36 percent by the end of 2006.[7] Of employers signing up for HSAs, they are disproportionately small and medium size businesses.[8] Similar growth for HDHPs is predicted by a survey of California businesses[9], which would likely bring with it an increase in HSAs.

ASSESSMENT AND IMPACT

Contrary to the assertion of proponents, HSAs and their companion HDHPs are a threat to the health of individuals and to the stability of the overall health care system. After a discussion of the dangers, this assessment concludes with a discussion of who is likely to benefit from the growth in HSAs — the wealthy looking for an additional tax shelter, banks who maintain those tax shelters and employers interested in transferring health care costs to employees.

HSAS CREATE RISKS FOR THE HEALTH OF INDIVIDUALS, ESPECIALLY LOW-INCOME PERSONS AND CHILDREN. While the research is still preliminary, the risks posed by HSAs are clear on a conceptual level and are supported by research that has already been conducted. HSAs:

- **Force the patient to play doctor and will likely reduce utilization of needed health care.** Implicitly assumed as part of the HSA model is that patients are rejecting health care that they do not need. But as patients attempt to play doctor, they will make errors in their decisions. According to research by the Rand Corporation, a higher level of cost sharing will reduce utilization of needed medical services, such as the use of antibiotics.[10] While its study showed that higher cost sharing did lead to reductions of some unneeded services, it also confirmed that patients were just as likely to avoid necessary treatment.

For HSAs, the risk-reward ratio is highly unfavorable. The perverse incentives HSAs create for individuals to actually forgo necessary prevention and care of chronic conditions far outweighs the available cost savings possible in the deductible portion of health expenditures. HSAs are a short-sighted strategy with significant potential to create greater costs in the long run.

- **More paperwork for individuals.** One of the most significant problems in health care is the undue administrative waste. In 2004, the fastest growing cost driver was administrative costs.[11] HSAs add further administrative burdens. Under HSAs, individuals and families have additional record keeping to do — along with the additional forms needed to make payments. This could increase inefficiencies and create additional barriers to access. A recent survey found that those enrolled in traditional insurance plans are much more satisfied than those enrolled in HSAs plans.[12]

- **Require currently nonexistent tools to help consumers understand health care quality.** Beyond the need for patients to fill out additional paperwork as described immediately above, CDHC requires patients to be able to determine which providers offer quality and cost-effectiveness. A key tenant of CDHC is that consumers will be able to "better" control their health care costs by finding high-quality, low-cost medical care providers. However, consumers could do this today without HSAs, yet there is no evidence of this accruing to any meaningful level.

  The reason they do not is primarily two-fold. First, patients are ill equipped to make such decisions.[13] Second, the tools and information needed for such decisions do not exist.[14] There is limited information on health care pricing and even more limited information on health care quality. Some large employers that offer HSAs have begun this process. While it is critical that the United States develop uniform and easily understandable information sources, HSAs will not remove the political and structural barriers that have prevented this from occurring already. Indeed, when major purchasers have tried to seek quality information, they have failed — the skyrocketing health costs of the last four years are proof of their failure. Given the limited information available today, some researchers have suggested that it is dangerous for patients to make care decisions under the current system.[15]

- **Increase the financial risk to individuals.** Although employers can make payments to HSAs, they are not required to do so. As a result, HSAs will likely increase an individual's financial payments since an employer's contribution is reduced.[16] As a result, an employer could offer an HSA plan and reduce its overall contribution to health care. As is discussed throughout this paper, there is no reason to believe that HSAs will reduce health care spending in the long run.

In an initial survey of HDHPs, it seems clear that enrollees are in fact paying more. According to survey results published by EBRI, a national research institution, 42 percent of those in HDHPs spent 5 percent or more of their income on out-of-pocket costs and premiums in the previous 12 months. This compared to only 12 percent of those in traditional plans who paid an equivalent percentage of income.[17] At least one other survey found similar results.[18] This burden could be devastating to low-income families where HDHPs could mean garnished wages and bankruptcy.[19]

- **Discourage the use of preventive and disease management techniques.** HSAs require individuals to pay for "first-dollar" coverage, therefore creating an incentive to forgo care. While some HDHPs in the private market exclude preventative and chronic care from the deductible, many do not. It is these plans that have the potential to drive up costs in the future because individuals will avoid purchasing initial care that could prevent higher future costs. Research shows that low-income people will forgo needed care in the face of higher costs.[20] In fact, a 2005 survey of persons enrolled in health insurance plans reports that 35 percent of persons in CHDPs reported delaying care as compared to 17 percent who were enrolled in comprehensive plans.[21] For children, the danger is significant as the benefits of preventative care are well established.[22]

- **Further fragmentation in care delivery.** America's health care system is highly fragmented. Many individuals, particularly the elderly and those with chronic conditions, will have multiple doctors. HSAs encourage further fragmentation by creating an incentive for individuals to see a variety of providers trying to seek a lower price versus seeing one provider for a medical home. This will be highly disruptive to the continuity of care if an individual sees one doctor one month and another doctor for the same condition the next month. Again, children are especially vulnerable to disruptions in the continuity of care.[23]

HSAS JEPORDIZE THE OVERALL HEALTH CARE SYSTEM AND WILL LIKELY INCREASE OVERALL COSTS. Research shows that the most likely major effect of high deductible health plans and HSAs is to create a one-time shift in spending – from paying for insurance premiums to paying for patient out-of-pocket expenses. While there is little reason to believe that costs will go down, there are many reasons to believe that spending may increase in the long run. HSAs:

- **Put the health insurance system at risk.** Insurance can only function when there is a pool that brings risk together. Since high deductible plans do not offer first dollar coverage, healthy persons are more likely to leave the risk pool of traditional insurance products to purchase HSAs. If healthy people leave the traditional risk pool, then there is greater risk of system collapse.[24] This type of adverse selection could lead to private health insurance becoming unaffordable those who need it the most.[25] The risk pools used by small employers will be more at risk than those for large employers.[26]

HSAs are essentially the same concept in another of President Bush's policy initiatives, the privatization of Social Security. Under that plan, individuals withdraw money from their Social Security account to invest in a separate account. The concept was highly criticized as destabilizing, and HSAs are no less dangerous to our overall health care system. HSAs allow the healthy to exit the traditional health insurance system, leaving those that remain — such as the chronically ill — to face higher costs and a much more insecure system.

- **Fail to address the true cost drivers in health care.** While estimates may vary, about 20 percent of the population accounts for 80 percent of the health care costs. In fact, only 4 percent of health care expenditures occur in households where spending is below $1,000, the minimum deductible required for a health plan that can be coupled with an HSA. As a result, it is unlikely that altering the spending patterns of low health care spenders will be sufficient to change the dynamics of the $1.9 trillion health care market. Regina E. Herzlinger, a professor at Harvard Business School, was recently quoted asking, "…how will [these HSAs] control the health costs that are hobbling our global competitiveness?"[27] Finally, in addition, most of the growth in health care spending is due to technological innovation—an area of health care unaffected by HSAs.[28]

- **Create higher costs for the health system.** As discussed, higher out-of-pocket costs will lead to reduced utilization. By forging preventative and primary care, the health system will see increased costs due to an increase in longer, more frequent hospital stays and poorer outcomes.[29] These findings are a significant warning sign for policymakers who believe that HSAs should be expanded.

- **Will not offer the needed help to the uninsured.** Research clearly shows that the uninsured receive about half as much care as the insured.[30] HSAs bring a significant risk to the stability of the health insurance system, but HSAs and their companion HDHPs will do little to help the uninsured because they will likely be unable to afford them, as determined by researchers at Columbia University.[31] Two–thirds of the uninsured have incomes less than twice the federal poverty level. These same researchers found that most low-income individuals cannot afford insurance coverage if premiums exceed 5 percent of their income, and an HSA approach could cost as much as 20 percent of some persons' income.

- **Put California's hospitals at risk, especially safety net hospitals.** At the Department of Insurance hearing in September 2005, a representative of the California Association of Public Hospitals (CAPH) explained that health plans lacking an inpatient hospital component could put safety net hospitals at financial risk. The CAPH representative also explained that California's unique Medi-Cal hospital payment structure could result in hospitals not being paid fully for HSA patients.[32] For all hospitals, there could be higher collection rates for CDHC plan enrollees, possibly leading some hospitals to seek credit checks before treatment.

HSAs SEEM BETTER SUITED TO OFFERING SUPPORT FOR THOSE WHO ARE NOT IN NEED, AND OF SERVING AS TOOLS FOR IMPROVING INVESTING RATHER THAN FOR IMPROVING HEALTH CARE. As described above, HSAs jeopardize the health of individuals and put the overall health care system at risk. At the same time, HSAs clearly offer support to the wealthy and to the investment banking community.

- **Are designed as tax breaks for the wealthy.** For HSAs, neither contributions nor expenditures are taxed. As a result, HSAs are an excellent tax shelter and will likely become a popular investment tool.[33] As one company that helps corporate America to understand fringe benefits explained it, "high income employees will use HSAs as a good investments and long-term planning tool," adding that "HSAs are the triple crown of tax planning."[34] This point is reiterated by Massachusetts Institute of Technology economist Jon Gruber, who said, "The new tax breaks would be expensive and regressive, offering the largest benefits to the highest-income taxpayers."[35]

- **Create a new boom market for investment banks instead of helping with health care.** As with Social Security privatization, financial institutions would benefit by the mass proliferation of private accounts for HSAs. In fact, health insurers and financial institutions have already been preparing HSA products. According to a recent *New York Times* article, "Banks and others are drawn by the promise of lucrative fees they can generate by offering consumers mutual funds and other investment vehicles as their account balances grow. Most also charge $50 to $75 to set up a health savings account, and they collect perhaps $40 or more each year in maintenance charges and service fees."[36] A leading financial industry analyst has called HSAs a "gold rush" for the banking industry.[37]

- **Support employer efforts to transfer health care costs to employees.** For employers, HSAs are an effective way of shifting costs to employees. HSAs and HDHPs can be offered by employers for substantially less than comprehensive plans. While HSAs may benefit the business, the overall health care system will be weaker as businesses reduce their financial support. Employer contributions to health insurance will continue to be critical to the health care system under any reform strategy.

CONCLUSION

Health Savings Accounts pose a clear danger to the health care system. At best, these are nothing more than investment vehicles for the rich and healthy. At worst, and more likely, HSAs will weaken the already fragile health insurance system, transforming it into a fragmented market place in which consumers must fend for themselves, regardless, of financial resources, medical sophistication or health status.

At a time when much of the budget is already dedicated to other tax breaks and Medicaid is facing the possibility of a $10 billion cut, HSAs are an expensive gimmick that shifts critical resources from programs that could support the uninsured, such as public health insurance programs and funding for safety net providers.

Even more of a threat to the safety net is the misguided notion that HSAs should not only be expanded for the uninsured but to those in public insurance programs. Several states are considering shifting all or part of their Medicaid programs over to an HSA-type approach.[38] HSAs constitute a dangerous experiment, and targeting it to the most vulnerable in society can only end with a weakened health care model.

While beyond the scope of this paper, there are viable, constructive solutions to the rising costs of health care and to the uninsured. For additional information, the California Department of Insurance offers analysis and detail on these concepts and others in *Priced-Out: The State of California Health Care*.[39]

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[1] Although beyond the scope of this report, CDHPs include products beyond those mentioned here, such as health reimbursement accounts and tiered health plans.

[2] In 2006, the deductible levels are $1,050 for an individual and $2,100 for a family.

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